November 26, 2002

The Honorable Board of Supervisors
County of Los Angeles
383 Kenneth Hahn Hall of Administration
500 West Temple Street
Los Angeles, CA 90012

Dear Supervisors:

HACIENDA HEIGHTS APPLICATION FOR CITY INCORPORATION (ALL DISTRICTS AFFECTED) (3 VOTES)

CAO RECOMMENDATION

IT IS RECOMMENDED THAT YOUR BOARD:

1. Adopt as your Board's revenue neutrality position the Chief Administrative Officer's revenue neutrality offer dated November 14, 2002 that is based upon data provided by the Executive Officer of the Local Agency Formation Commission on November 7, 2002.

2. Request, pursuant to Government Code Section 57384(b), that the Local Agency Formation Commission require, as a term and condition in any resolution approving the proposed incorporation that, in the event of incorporation, the City of Hacienda Heights reimburse the County of Los Angeles for the net cost of services provided during the first fiscal year that incorporation becomes effective, with interest on any unpaid balance accrued annually and paid to the County at the rate earned by the County's Treasury Pool.

3. Request that the Local Agency Formation Commission require, as a term and condition in any resolution approving the proposed incorporation, the transfer to the proposed City of ownership and operational responsibilities for all County local parks and attendant facilities, subject to the following two further conditions: (a) that such parks and facilities shall be equally open to residents of incorporated and unincorporated territory and there shall be no discrimination against, or preference, gratuity, bonus or other benefit given to residents of incorporated areas not equally accorded residents of unincorporated territory; and (b) that the City shall be responsible for complying with all State and Federal guidelines in operating the parks and their attendant facilities.

PURPOSE/JUSTIFICATION OF RECOMMENDED ACTION

Board Action

On October 15, 2002, your Board adopted policies to provide guidance to County staff in revenue neutrality negotiations with the Hacienda Heights Cityhood Organization (HHCO) regarding the Hacienda Heights proposed incorporation. In that Board letter, the Chief Administrative Office (CAO) also outlined a number of issues concerning the accuracy and completeness of the comprehensive fiscal analysis (CFA) prepared by the Local Agency Formation Commission (LAFCO).

LAFCO Action

On October 23, 2002, LAFCO took action to direct its Executive Officer to review the CAO's issues related to the CFA. Based upon this review, the LAFCO Executive Officer on November 7th released a series of **draft** budgetary scenarios (Attachment I) for the proposed City of Hacienda Heights that included responses to the CAO's issues as follows:

1. Adjustments to reflect the "Auditor's Ratio" issued by the Auditor-Controller on November 4, 2002, including Tobacco Settlement and the State Educational Revenue Augmentation Fund (ERAF) as general purpose revenues.

2. Inclusion of the actual Sheriff law enforcement expenditure data for Fiscal Year 2002-01, in accordance with Government Code Section 56800. (NOTE: The CFA used projected contract law enforcement costs rather than actual expenditure data.)

3. Provision of two options, 5 percent and 10 percent, for the percentage of contingency reserve to be budgeted. A 10 percent contingency fund would be in compliance with the recommendations of the State LAFCO Incorporation Guidelines.

4. Adjustment of Fines and Forfeiture revenues to reflect a prorated amount of actual 2000-01 fine and forfeiture revenue. The prorated amount of actual revenue is based upon the population in Hacienda Heights as compared to the total unincorporated area population. The CFA had used an estimated amount based upon fines and forfeiture revenues collected in similar sized cities. Fines and Forfeiture revenue is considered a general purpose revenue and has been included as such in the Auditor's Ratio.

On November 8, 2002, the LAFCO Executive Officer issued a memorandum regarding the November 7th scenarios and the issues raised by the CAO and the HHCO and the status of the issues. In this memorandum, the Executive Officer agreed to use the Auditor's Ratio and the Sheriff's actual expenditures for FY 2000-01, although the Executive Officer's determination on other issues remains unknown at this time. (Attachment II)

Revenue Neutrality: State Statutory Provisions

California Government Code Section 56815 (Attachment III) provides that LAFCO shall not approve a city incorporation proposal unless it finds that expenditures and revenues to be transferred between the County and other affected agencies <u>and</u> the proposed city are "substantially equal." Section 56815 provides two exceptions under which LAFCO may ignore the substantially equal requirement: (1) the County and all other affected agencies have agreed to a proposed transfer that is not substantially equal; or (2) LAFCO finds that the negative fiscal effect created by a transfer of revenues and expenditures that is not substantially equal has been "adequately mitigated" by tax sharing agreements, lump-sum payments, payments over a fixed period of time, or other terms and conditions imposed by LAFCO.

The Amount of Revenue Neutrality

The August 2002 CFA estimates that current revenues that would transfer to the proposed City exceed current expenditures for services transferred by $2,596,060. This figure has been recalculated based upon LAFCO's response to the CAO's issues discussed above and is estimated to be $2,454,754 per year in LAFCO's November 7, 2002 materials.

Revenue Neutrality Proposals

1. CFA Revenue Neutrality Proposals

The CFA provides three potential revenue neutrality scenarios:

Scenario 1: Assumes revenue neutrality mitigation payments begin in year one at the full amount and will be reduced by 10 percent per year which results in the total cancellation of revenue neutrality mitigation payments in the 11th year. This scenario provides for the least amount of fiscal mitigation, $14,278,330, and therefore, is the best scenario for the viability of the City. The impact to the County over a 25-year period is $50,623,170 when compared to full revenue neutrality over that period of time (see Scenario 3 below).

Scenario 2: Assumes full revenue neutrality mitigation payments for seven years totalling $18,172,420. This scenario also provides for a fiscally viable City; however, it results in a County impact over a 25-year period of $46,729,080.

Scenario 3: Assumes full revenue neutrality mitigation payments for 25 years. This scenario is the best case for the County, as it provides for a total of $64,901,500 in fiscal mitigation payments to the County. While the projections indicate that the City would have a surplus through year 10, the surplus begins to decline each year beginning in year 2010-11 based upon the continued mitigation payments. The CFA concluded that the implementation of this scenario rendered the City infeasible.

2. HHCO Revenue Neutrality Proposal #1

On September 23, 2002, HHCO submitted a revenue neutrality proposal containing the following elements (Attachment IV):

- The City shall pay a total of $8,750,000 in revenue neutrality mitigation, to be paid in equal payments of $1,250,000 over seven years..

- The County shall waive the requirement for reimbursement of all transition year costs

- The County shall continue to provide road maintenance services at no cost to the City for the first three fiscal years after incorporation.

- The County shall continue indefinitely to maintain and provide services at the Senior Center in Steinmetz Park at no cost to the City. The City and the County may enter into negotiations to transfer the facility to the City at either party's request.

3. <u>October 21, 2002 CAO Response to HHCO</u>

The HHCO and CAO staff met on October 16, 2002. At this meeting, the HHCO requested that the CAO respond to their September 23rd proposal, provide a counter proposal, prepare a list of regional services benefiting Hacienda Heights, and discuss why the CAO believes Proposition 172 revenues are applicable to the property tax transfer and revenue neutrality calculations. The CAO provided this response on October 21, 2002, indicating that the HHCO revenue neutrality proposal would cost the County $71.1 million over a 25-year period based upon the CFA calculations and the HHCO request for waiver of reimbursement for transition year costs, additional road services and the continued County operation of the Senior Center at Steinmetz Park. (Attachment V)

4. <u>October 22, 2002 HHCO Proposal</u>

At the second negotiation meeting, HHCO presented a revised revenue neutrality proposal that would provide the County with $10 million in revenue neutrality mitigation, paid in equal installments of $1 million over 10 years and eliminate the additional two years of County road maintenance at no cost to the City. All other terms were the same as the September 23rd HHCO proposal. This proposal would cost the County $63.9 million over a 25-year period. (Attachment VI)

5. November 7, 2002 LAFCO "Draft" Scenarios

After factoring in the issues raised by the CAO with the CFA, LAFCO recalculated the annual revenue neutrality mitigation requirement (reduced from $2,596,060 per year to $2,454,754 per year) based upon the revised expenditures and revenues to be transferred. LAFCO also provided three "draft" revenue mitigation scenarios using the revised calculations. Each scenario also contained two options or alternatives relative to the amount of reserve for contingencies: for each scenario, Alternative A assumes a 5 percent contingency and Alternative B assumes a 10 percent contingency. All scenarios assume the County is reimbursed for transition year costs with interest. (Attachment I)

Scenario 1: Ten-year mitigation payment schedule with the annual mitigation payment reduced by 10 percent per year. Total payments to the County are $13,501,147. The proposed City of Hacienda Heights has a cumulative general fund balance of $11,234,048 at the end of the 10th year with a 5 percent contingency reserve and $6,334,371 with a 10 percent contingency reserve. The impact to the County over a 25-year period under this scenario is $47,867,703.

Scenario 2: Seven-year mitigation payment schedule with no reductions in payments. Total payments to the County are $17,183,278. The cumulative general fund balance for the proposed City of Hacienda Heights at the end of the 10th year is $7,218,388 with a 5 percent contingency reserve and $2,318,711 with a 10 percent contingency reserve. Scenario 2 results in a County impact over a 25-year period of $44,185,572.

Scenario 3: Ten-year mitigation payment schedule with the annual mitigation payment reduced by 5 percent per year. Total payments to the County are $19,024,343. The proposed City of Hacienda Heights has a cumulative general fund balance of $5,451,265 with a 5 percent contingency reserve and $551,587 with a 10 percent contingency reserve. The County impact under this scenario over a 25-year period is $42,344,507.

Transition Year Costs

State law generally provides that counties continue to furnish, without additional charge, all services furnished to the area prior to its incorporation for the remainder of the fiscal year during which the incorporation becomes effective or until the city council requests discontinuance of the services, whichever occurs first. A city is required to reimburse the County for the net cost of those services if the County requests such reimbursement prior to LAFCO's adopting a resolution approving the incorporation.

The only exception to this reimbursement is the cost of providing road maintenance. It appears that the County is required to expend County road maintenance related funds during the transition year and will not be reimbursed by the City.

Revenue Neutrality Impact on County Responsibility

- The County is responsible for providing regional services countywide for the health and safety of all County residents. In unincorporated areas, the County provides residents and property owners with municipal services as well as regional services. Thus, while the incorporation of Hacienda Heights would relieve the County of the responsibility for providing municipal services to city residents, the County will continue to be responsible for the provision of regional services to residents within the boundaries of the city.

- The revenue neutrality payment insures that the County has the funding available after the effective date of a city's incorporation to maintain regional services at current levels without adversely affecting municipal services in the remaining portions of the County unincorporated area. In the absence or severe reduction of the revenue neutrality payment, the proposed city would receive a revenue windfall by having the benefit of County revenue currently used to finance regional services without any responsibility for providing such services. The resulting revenue windfall would allow the city to provide a higher level of municipal services to its residents, while the County will be forced to reduce either regional services or municipal services within the remaining unincorporated area, or a combination of the two. The enhanced services enjoyed by the proposed city residents would occur at the expense of the County's regional service recipients or unincorporated area residents who would suffer a reduction in such services.

- The above conditions are magnified by the County's current fiscal condition which is negatively impacted due to the State's budgetary curtailments and the future deficits in the County's Health Department.

As indicated in the CFA, the proposed City of Hacienda Heights cannot incorporate and remain fiscally viable under a full revenue neutrality payment option. Fiscal viability can only be achieved through subsidization of the proposed City with revenues that should stay with the County under a strict implementation of the revenue neutrality concept.

CAO Revenue Neutrality Offer

In order that your Board would have the ability to provide LAFCO with a revenue neutrality proposal that, based on the current financial data provided by LAFCO on November 7, 2002, would be consistent with City fiscal viability and would allow LAFCO, if it so chooses, to approve the incorporation proposal for submission to the voters of Hacienda Heights, the CAO on November 14, 2002, submitted to the HHCO a revenue neutrality offer. (Attachment VII) The CAO's offer provides the greatest revenue neutrality mitigation to the County, $24,547,540, while being consistent with fiscal viability of the proposed City of Hacienda Heights according to LAFCO released data. Although the 10th year of this offer (2012-13) reflects a slight deficit of $72,000, the HHCO has indicated in negotiation meetings that revenues are understated in the CFA, and that they are confident of a number of potential revenue generation options not included in the CFA.

The impact of the offer in terms of lost revenue to the County, when compared to a 25-year revenue neutrality payment is $36.8 million. By comparison, LAFCO's November 7, 2002, Scenario 3 would result in a $42.3 million loss of revenue to the County over a twenty-five (25) year period.

CAO staff met with the HHCO on November 15, 2002, to discuss the CAO's offer. HHCO was unable to provide a response to the offer at that time and indicated it would respond no later than Tuesday November 19, 2002. Therefore, while it was necessary for the CAO to file this Board letter on Monday, November 18th, HHCO and CAO agree to continue to negotiate, and a memorandum reflecting the status of the negotiations will be presented to your Board on or before November 26, 2002.

Other Issues

Whether or not your Board adopts the CAO revenue neutrality offer, or some other revenue neutrality alternative, the CAO recommends that your Board request LAFCO to take the following actions if it choses to approve an incorporation proposal:

- Require as a term and condition of any resolution approving the proposed incorporation that, in the event of incorporation, the City of Hacienda Heights reimburse the County of Los Angeles for the net cost of services provided during the first fiscal year that incorporation becomes effective, with interest on unpaid balances accrued annually and paid to the County at the rate earned by the County's Treasury Pool.

- Consistent with longstanding policy and practice of the County to transfer jurisdiction and operational responsibilities for all County local parks and attendant facilities to a newly incorporated city, require, as a term and condition in any resolution approving the proposed incorporation, the transfer to the proposed City of ownership and operational responsibilities for all County local parks and attendant facilities, subject to the following two further conditions: (a) that such parks and facilities shall be equally open to residents of incorporated and unincorporated territory and there shall be no discrimination against, or preference, gratuity, bonus or other benefit given to residents of the City not equally accorded residents of unincorporated territory; and (b) that the City shall be responsible for complying with all State and Federal guidelines in operating the parks and their attendant facilities. The local parks within the proposed City boundaries of Hacienda Heights to be transferred are: Steinmetz Park and Senior Center, Countrywood Park, Los Robles Park, Manzanita Park, Pepperbrook Park, and Thomas Burton Park.

Although, the proponents of Hacienda Heights consider Steinmetz Senior Center as a regional facility because residents of both Hacienda Heights and Rowland Heights use the facility, the construction of the Senior Center was financed through Proposition A funds and Federal block grants which were based on the low/moderate income level of the seniors in Hacienda Heights. Moreover, the CFA accounts for and includes in the revenue transfer computations, the County general funds appropriated to the County

Department of Parks and Recreation for the operation of the Senior Center. It should also be noted that the proposed City of Hacienda Heights would not be precluded from charging reasonable fees for use of the senior facility so long as City residents and unincorporated area residents are charged, and otherwise treated, equally.

Finally, the following additional issues need to be noted:

- Road maintenance expenditures presented in LAFCO's November 7th scenarios are almost one-half of the expenditure level reflected in the CFA. The CFA based its road maintenance expenditures on Department of Public Works (DPW) actual costs for 2000-01. If Hacienda Heights finances road maintenance at the expenditure level in LAFCO's November 7th scenarios, DPW could not provide service without jeopardizing sound engineering practices and without the potential risk of considerable County liability. Therefore, DPW would probably not recommend contracting with the City of Hacienda Heights to provide road maintenance services. The new City would need to contract with another entity, either private or public, for road maintenance services.

- The contract law enforcement costs reported in the CFA were provided by the Sheriff's Department and reflect what the new City would need to pay for a base level of contract law enforcement services from the County.

Implementation of Strategic Plan Goals

The CAO recommendation is consistent with the following Strategic Plan Goals and Strategies:

--Goal No. 3: Organizational Effectiveness
Strategy No. 3, Collaborate across functional and jurisdictional boundaries.

--Goal No. 4: Fiscal Responsibility
Strategy No. 1, Manage effectively the resources we have.

FISCAL IMPACT/FINANCING

Revenue Neutrality: In the event that the incorporation proposal is allowed to proceed to election and is approved by the voters of Hacienda Heights, we recommend that the revenue neutrality mitigation scenario with the greatest possible payment to the County, while still being consistent with fiscal viability based upon LAFCO's fiscal projections, should be endorsed. The CAO's offer of November 14, 2002 currently reflects the least negative fiscal impact to the County (estimated at $36.8 million over a 25-year period), while being consistent with City fiscal viability.

General Fund Services During First Year: The County should be reimbursed for the net cost of general fund services provided to the new City during the first fiscal year in which incorporation occurs. Additionally, the proposed City would own and operate all County local parks and attendant facilities, based upon the contingencies noted previously.

Road Fund Services During First Year: If the Hacienda Heights incorporation proposal is approved by the voters, the County road fund will continue to fund road maintenance and transit services to the City during the first fiscal year of incorporation, and will not be reimbursed for those services by the City. DPW's current work program estimates $2.3 million in road maintenance costs and $0.2 million in transit services during 2003-04.

Incorporation Election Costs: Under Government Code Section 57150, in the case of incorporation, the newly incorporated City, if successful, will pay the expenses of the elections; however, if unsuccessful, the County will bear the election costs. The County Registrar-Recorder/County Clerk estimates the costs of a June 2003 election on the Hacienda Heights incorporation proposal to be $110,000.

FACTS AND PROVISIONS/LEGAL REQUIREMENTS

Attachment VIII provides additional detail regarding the legal requirements for an incorporation once an application is received by LAFCO.

IMPACT ON CURRENT SERVICES (OR PROJECTS)

Adoption of the CAO recommendation would provide the least negative fiscal impact on the County and related curtailments in services provided by the County as a result of the proposed incorporation, while still being consistent with fiscal viability based upon LAFCO data.

Respectfully submitted,

DAVID E. JANSSEN
Chief Administrative Officer

DEJ:LS
MKZ:DSP:nl

Attachments (8)

c: Sheriff
County Counsel
Director of Animal Care and Control
Auditor-Controller
Director of Consumer Affairs
Director of Parks and Recreation
Director of Public Works
Director of Planning
Treasurer and Tax Collector